

PROFESSOR GODLEY: Thank you for asking me to come. I'd like to move straight to Professor Blinder's dark side. The trade deficit is generating a growing international debt. It was 15 percent of GDP at the end of last year and it probably is now 20 percent of GDP. The rate of interest, the overall net rate of interest, a messy concept, probably now exceeds the growth rate at the margin and, therefore, the existing deficit implies growing and ultimately exploding interest payments.

This implies that there absolutely has to be a correction at some stage. I've made some projections in my written testimony to indicate the scale and timing of what might happen. And they show an absolutely inexorable, but perhaps quite lengthy process. Nevertheless, it is inexorable and absolutely requires that an improvement take place.

Now this story implies that the balance-of-payments deficit grows in excess of the trade deficit and

grows even if the trade deficit stabilizes. Under these circumstances, the balance-of-payments deficit wouldn't by the saving investment balance be determined, it would be entirely determined by the size of the debt and the size of the rate of interest. Savings doesn't come into that story at all.

There's no escaping the fact that to turn things around requires a big improvement in the trade balance, but this doesn't happen automatically. We know that it doesn't happen automatically because there are so many cases of countries where it hasn't happened automatically. I have particularly in mind the case of Denmark, a well-managed, modern economy, I would say, which in the 1980s ran into exactly this problem and there was no automatic correcting mechanism.

So now what I say may be a false alarm. I mean the trade deficit may improve by itself, although I don't myself see why. But I only have to establish the possibility that these things, the real risk that these

things will happen, to make a case for thinking out what corrective policy would be appropriate.

The most vulnerable part of my calculations, in my opinion, concerns what I call the rate of interest, the overall rate of interest. And it's vulnerable because the published figures are genuinely difficult to interpret. And one particularly important point, as I see it, is that the recorded rate of inward direct investment has recently been extremely large. And that looks very optimistic and a lot of people have drawn attention to it. But it has this unusual and, I think, new feature about it that it is financed either entirely or very nearly entirely by exchange of shares which means that no transaction, no financial transaction takes place at all. However, the figures, the published figures, don't enable one to distinguish direct investment financed in this way from direct investment financed by, say, cash purchase. It would be a very great advantage from the point of view of economic analysis if we could

have a memorandum item which distinguished direct investment financed in the two different ways.

Well, there are other problems, statistical problems. The major mystery and it really impedes interpretation of the figures, is that the rate of return on foreign direct investment in this country has been so low. If this was because of transfer pricing, for instance, this could have a major impact on one's interpretation of what's going on.

But when it comes to remedies, I feel a bit foolish talking about them because the whole concept of an active economic policy has so badly gone out of fashion. But that's what I'm called on to do in this case. And it comes down to -- I'll pick up on some of the points that were already made. It really comes to expenditure reducing policies which is to be deplored, I think, because it is allowing the major imbalances in trade potentially to impart a deflationary impulse to the

world's system and, of course, to the U.S. system and becomes a threat to full employment.

To increase foreign demand would help. But there are no other institutions nor agreed principles of action which would lead one to know how to proceed at the moment. And thirdly, there is, anyway, what ought to be the most hopeful thing which is changing export and import propensities. The classic way of doing that is by currency depreciation. Under modern conditions, currency depreciation isn't really an instrument of policy anymore and there is no guarantee that this will happen automatically through market forces. I, therefore, draw the Commission's attention -- and I can go no further than that -- to the fact that there is Article 12 in the GATT, creatively changed in the Uruguay Rounds when the WTO came into existence. This sponsors the used import controls, in extremis, as carefully as specified and described in the article of GATT is an instrument of policy. As I said in my written statement,

Keynes did once say that the great thing about import controls is that they stop imports from coming in.

VICE CHAIRMAN PAPADIMITRIOU: Thank you very much.

Dr. Lawrence?